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Navigating the alternatives landscape

In a market where volatility reigns, investors seeking to improve returns can do so by learning to manage the complexities of private equity and hedge fund investing, writes Steve McMenamin.

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We live in an unpredictable world and investors are feeling the effects.

Fiduciaries are grappling with ways to generate returns that are not correlated to the broader stock and bond market with an appropriate amount of risk.

Studies have shown that investors can expect better returns if they pepper their portfolios with private equity and other alternative investments. But the complex nature of these investments, coupled with a 100-year financial storm every three years, has made alternative investing more challenging.

Yet if investors want to generate sizeable returns they need to learn to how to live with a little uncertainty. It is possible to successfully invest in alternatives if investors are willing to understand and manage the many risks associated with private equity and hedge fund investing.

Steve McMenamin

The good news is that in exchange for a little variability, investors have the opportunity to benefit from the ability to source returns from a broader spectrum of opportunities. We want to be able to invest in managers and strategies that are different from one another, and more importantly, as uncorrelated as possible with the stock market.

Understanding volatility, leverage and liquidity and knowing how these factors together can compound risk, can help investors know what they own and how it behaves. Ongoing due diligence, manager monitoring, and stress testing and projections with various scenarios can also help avoid unpleasant surprises.

Most importantly, fiduciaries need to understand that the objective of any risk management measure is not to predict future events, but rather to understand the vulnerabilities their portfolios may be exposed to. Investors need to consider rare events in order for their portfolios to be prepared and protected.

So let volatility work for you. Uncertainty can create periods of opportunity and opportunity can create the potential for improved returns.

Steve McMenamin is the executive director of The Greenwich Roundtable, a non-profit research and educational organisation for investors who allocate capital to alternative investments.